No. 10130.

IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

UNITED STATES OF AMERICA,

Appellant,

vs.

H. F. METCALF, as Trustee in Bankruptcy of the Estate of F. P. Newport Corporation, Ltd., a corporation, Bankrupt,

Appellee.

Upon Appeal from the District Court of the United States for the Southern District of California

---

BRIEF FOR THE UNITED STATES.

SAMUEL O. CLARK, JR.,
Assistant Attorney General.

SEWALL KEY,
SAMUEL H. LEVY,
ARTHUR MANELLA,
Special Assistants to the Attorney General.
United States Post Office and Court House Building, Los Angeles,

WM. FORET PALMER,
United States Attorney.

E. H. MITCHELL,
Assistant United States Attorney.

EUGENE HARPOLE,
Special Attorney,
Bureau of Internal Revenue.

Hall & Dunn Company, Law Printers, Los Angeles

TOPICAL INDEX.

TABLE OF AUTHORITIES CITED.

CASES. PAGE

STATUTES.

MISCELLANEOUS.

No. 10130.

IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

UNITED STATES OF AMERICA,

Appellant,

vs.

H. F. METCALF, as Trustee in Bankruptcy of the Estate of F. P. Newport Corporation, Ltd., a corporation, Bankrupt,

Appellee.

Upon Appeal from the District Court of the United States for the Southern District of California.

BRIEF FOR THE UNITED STATES.

Opinion Below.

There has been no previous opinion in this case. The District Court, in the order appealed from, adopted as its findings of fact and conclusions of law the findings and conclusions of the referee in bankruptcy. [R. 188-189.] The latter may be found at R. 28-41.

Jurisdiction.

F. P. Newport Corporation, Ltd., a corporation, having its principal place of business in the City and County of Los Angeles, State of California, was adjudicated a bankrupt on January 12, 1937, at Los Angeles in the District

Court of the United States for the Southern District of California, and the matter was referred to a referee. [R. 6-7.] On December 17, 1941, the District Court entered an order sustaining the action of the referee in disallowing a claim of the United States for income taxes for the calendar years 1938 and 1939. [R. 188-189.] The jurisdiction of the District Court over the proceeding and the claim is conferred by Section 24, Nineteenth, of the Judicial Code, as amended, and by Section 1 (10) and 2a of the Bankrtuptcy Act, and in particular subsections (1) and (2) and (5) thereof. Provision for reference of the proceedings to the referee and for review of the order of the referee is found in Sections 22 and 39c of the Bankruptcy Act.

Notice of appeal was filed on January 13, 1942. [R. 190-191.] Jurisdiction is conferred on this Court by Section 128(c) of the Judicial Code, as amended by the Act of February 13, 1925, and Section 24a and b of the Bankruptcy Act.

Question Presented.

The question is whether a trustee in bankruptcy of a corporation engaged in the business of buying and selling real property for profit, who took over the bankrupt's assets, entered upon a program of selling the properties over a period of time, made repairs and improvements, and executed leases, is subject to income tax upon the net income derived from such activities. The answer depends upon whether the trustee was "operating the property or business" within the meaning of Section 52 of the Revenue Act of 1938 and Section 52(a) of the Internal Revenue Code.

Statutes and Regulations Involved.

Revenue Act of 1938, c. 289, 52 Stat. 447:

SEC. 52. CORPORATION RETURNS.

Every corporation subject to taxation under this title shall make a return, stating specifically the items of its gross income and the deductions and credits allowed by this title and such other information for the purpose of carrying out the provisions of this title as the Commissioner with the approval of the Secretary may by regulations prescribe. The return shall be sworn to by the president, vice president, or other principal officer and by the treasurer, assistant treasurer, or chief accounting officer. In cases where receivers, trustees in bankruptcy, or assignees are operating the property or business of corporations, such receivers, trustees, or assignees shall make returns for such corporations in the same manner and form as corporations are required to make returns. Any tax due on the basis of such returns made by receivers, trustees, or assignees shall be collected in the same manner as if collected from the corporations of whose business or property they have custody and control.

Section 52(a) of the Internal Revenue Code (U. S. C. 1940 ed., Title 26, Sec. 52) is identical with this provision.

Treasury Regulations 101, promulgated under the Revenue Act of 1938:

ART. 52-2. *Returns by receivers.*—Receivers, trustees in dissolution, trustees in bankruptcy, and assignees, operating the property or business of corporations, must make returns of income for such corporations. If a receiver has full custody of and

control over the business or property of a corporation, he shall be deemed to be operating such business or property within the meaning of section 52, whether he is engaged in carrying on the business for which the corporation was organized or only in marshaling, selling, and disposing of its assets for purposes of liquidation. Notwithstanding that the powers and functions of a corporation are suspended and that the property and business are for the time being in the custody of the receiver, trustee, or assignee, subject to the order of the court, such receiver, trustee, or assignee stands in the place of the corporate officers and is required to perform all the duties and assume all the liabilities which would devolve upon the officers of the corporation were they in control. (See sections 274 and 298 and articles 274-1 and 274-2.) A receiver in charge of only part of the property of a corporation, however, as, for example, a receiver in mortgage foreclosure proceedings involving merely a small portion of its property, need not make a return of income.

Section 19.52-2 of Treasury Regulations 103, promulgated under the Internal Revenue Code, is identical with this provision.

Statement.

The facts were stipulated. [R. 50-60.] The findings of the referee, which were adopted by the District Court, may be summarized as follows:

The bankrupt, F. P. Newport Corporation, Ltd., a Delaware corporation, was organized in 1929 to conduct a real estate business. It was engaged in the real estate business in California on and prior to March 19, 1935.

[R. 31.] The company was adjudicated a bankrupt on January 12, 1937, and H. F. Metcalf was appointed trustee on March 18, 1937. Since that date the trustee has had possession and control of all the property and assets of the bankrupt, consisting of numerous parcels of improved and unimproved real estate, accounts, promissory notes, bills receivable and other tangible and intangible property. [R. 31-32.]

Prior to the filing of the petition in bankruptcy, approximately 90% of the real estate was encumbered by a deed of trust in favor of the Security-First National Bank of Los Angeles, to secure an indebtedness in excess of $1,300,000. [R. 32.] The bank filed an unsecured claim for $500,000 based on a probable deficiency on the trustee's note. Other claims were filed in the approximate aggregate amount of $300,000. None of the claims has been paid. [R. 32.]

An agreement was reached between the trustee and the bank, with the approval of the District Court, authorizing the trustee to sell the property covered by the deed of trust and to collect rents and income from the properties. [R. 32-33, Ex. A.] Amounts received by the trustee were to be applied to taxes, upkeep expenses, and the balance to be paid on the principal and interest on the loan. [R. 69-70.]

Rather than make forced sales for less than he believed the property to be worth, the trustee "has conducted a selling program which would enable him to spread his sales over a period of time and take advantage of favorable market conditions." All sales made by the trustee were duly approved by order of the court. Pending sale, some of the properties have been rented by the trustee mainly for agricultural purposes. Repairs were made

upon certain properties, and improvements were made upon others to preserve them from the hazards of fire and flood. [R. 35.]

Among the real properties title to which is held by the bank under the declaration of trust are two parcels—one of three and the other of six acres, separated by an intervening three-acre parcel belonging to third persons. Both parcels are situated adjacent to what is known as Channel No. 3 of Long Beach Harbor in the City of Long Beach, California. During the pendency of the bankruptcy proceeding producing oil and gas wells were drilled and other wells were being drilled or about to be drilled on nearby lands which adjoined and surrounded said two parcels. It was feared by the trustee and said Security-First National Bank of Los Angeles that the operation of these wells would drain away the oil and gas believed by the trustee to underlie the same. The trustee in bankruptcy did not have sufficient funds to enable him to drill any oil or gas wells. By and with the approval of the court, he leased the two parcels of land to Universal Consolidated Oil Company. Other lots in the same general area which were not of sufficient size to be covered by separate leases, were included in a community oil and gas lease wherein the Bankline Oil Company was the lessee. [R. 33-34.]

Oil and gas royalties including bonuses actually paid to the trustee under the terms and provisions of the leases during the year 1938 amounted to $245,517.65 and during the year 1939 amounted to $206,333.36. These moneys were paid to the bank by the trustee upon orders of the court to cover taxes assessed against the properties, record legal title to which was so held by the bank as security for the indebtedness owing it, costs of engineering services for

checking oil and gas production on the property leased to Universal Consolidated Oil Company, and to apply on account of the interest and principal owing on the secured debt of the said bank. [R. 34.]

From the sales of real estate made during 1938 the trustee received $5,500, and during 1939, $18,650 from the same source. Eighty per cent of the moneys so obtained was paid to the bank by the trustee upon order of the court to apply on account of the principal and interest owing the bank. The balance of the receipts was retained by the trustee and used by him in the payment of expenses of administration. [R. 34-35.]

No general order of the court authorizing the trustee to conduct the business of the bankrupt corporation or forbidding him to do so has ever been made or signed. The court has made order authorizing the trustee to lease, pending sale thereof, unsubdivided lands, grant easements and rights of way to the City of Los Angeles and County of Los Angeles for street purposes, make sales of real property, cancel leases of real property, make payments upon the indebtedness of the bankrupt, compromise claims against the bankrupt, enter into agreements with the City of Long Beach, California, concerning rights to oil and gas produced under the Universal Consolidated Oil Company lease hereinbefore mentioned pending determination of title disputes to the property covered by the lease, renew contracts with the Oil Field Testing and Engineering Company, Inc., for checking of oil and gas production on said property, and to lease, pending sale, a barn belonging to the bankrupt estate for the storage of hay. [R. 36.]

On the basis of the books of account kept by the trustee, the Commissioner of Internal Revenue made his assessments as follows [R. 37-39]:

1938

RECEIPTS

By sales of real estate approved by Court	$ 5,500.00
Interest on bankrupt's accounts	203.80
Rents collected from miscellaneous properties	4,557.98
Ranch rentals	1,792.50
Collected on bankrupt's old accounts	2,007.00
Cash bonus (Universal Consolidated Oil Co. lease)	25,000.00
Oil bonus (Universal Consolidated lease)	25,000.00
Oil and gas royalties	195,517.65
Total	$259,578.93

DEDUCTIONS ALLOWED BY COMMISSIONER

Bankrupt's costs on real estate sold	$ 4,470.60
Commissions to brokers on sales	275.00
Trustee's branch office expenses	407.34
Verdugo tract upkeep expenses	126.53
Other properties upkeep expenses	729.71
Ranch upkeep expenses	191.30
Title expenses Re: Sales made	74.10
Interest paid Security-First National Bank	50,773.40
Taxes paid on properties	21,705.76
Trustee's office rent	1,440.00
Telephone and telegraph	394.50

Office supplies and expenses	885.58
Salaries of Trustee's assistants	5,145.01
Miscellaneous expenses including Trustee's bond	262.99
Other expenses (Loss of assets through foreclosure)	1,735.56
Depreciation on office fixtures and equipment	614.52
Depletion (oil)	67,517.35
Expense of checking oil and gas production on properties leased to Universal	1,920.73
Bankruptcy fees allowed by Court	13,842.53
Total	$172,512.51
Commissioner's Determination of Net Income	$ 87,066.42

1939

RECEIPTS.

By sales of real estate approved by Court	$ 19,450.00
Interest on contracts for sales of real estate	17.53
Rents from miscellaneous properties	4,650.76
Ranch rentals	2,038.75
Other receipts by sales from miscellaneous personal properties	81.00
Oil and gas royalties	206,333.36
Total	$232,571.40

DEDUCTIONS ALLOWED BY COMMISSIONER.

Cost of real estate sold	$ 30,770.40
Commissions to brokers on sales	1,256.50
Trustee's branch office expenses	1,418.98

Verdugo tract upkeep expenses	178.82
Ranch upkeep expenses	235.46
Other property upkeep expenses	1,462.30
Title expenses Re: sales made	424.70
Interest paid to Security-First National Bank	46,892.48
Taxes on properties	37,304.67
Trustee's office rent	320.00
Telephone and telegraph	334.06
Office supplies and expenses	1,173.81
Salaries to Trustee's assistants	4,727.53
Miscellaneous expenses including Trustee's bond	130.29
Expenses of checking production under Universal Consolidated oil lease	3,982.50
Depreciation on office fixtures and equipment	621.50
Depletion (oil)	56,741.67
Bankruptcy fees allowed by Court	14,306.82
Total	$202,282.41
Commissioner's determination of net income	$ 30,288.99

Statement of Points to Be Urged.

The Government relies on all the points specified [R. 200-201]. In substance, they are that the District Court and the Referee in Bankruptcy erred in failing to hold that the trustee in bankruptcy during the taxable years 1938 and 1939 was operating the property or business of F. P. Newport Corporation, Ltd., the bankrupt, within the meaning of Section 52 of the Revenue Act of 1938

and Section 52(a) of the Internal Revenue Code, and Section 19.52-2 of Treasury Regulations 103, and in holding that the net income received by the trustee during the taxable years in question was not subject to federal income taxes.

Summary of Argument.

By Section 52, Congress intended to tax the income received by trustees in bankruptcy from the operation of the property or business of which they have custody or control. The appellee here was operating the property or business of the bankrupt.

Selling, leasing, renting and managing real property has long been recognized as amounting to the carrying on of business. Here the trustee performed such activities, which other than the purchase of new properties, was precisely the same kind of activities as were previously carried on by the bankrupt. Only a minor part of the trustee's activities involved the liquidation of assets; almost all of the income in question was earned as a result of profitable oil and gas leases which the trustee himself executed. He was not a mere passive recipient of income. Even where income is produced from a process of liquidation, this is no reason why it should be exempt from tax.

In any event, the trustee clearly operated the *property* of the bankrupt, for he did everything with such property that the corporation itself could have done.

Even if the trustee had not engaged in leasing, renting, and managing the property, but had merely realized income from the sale of assets, under the applicable regulations he would be subject to the tax.

ARGUMENT.

The Trustee in Bankruptcy Was Operating the Property or Business of the Bankrupt Corporation and Is Therefore Liable for Income Tax Upon the Income Earned.

1. The manifest purpose of Congress in enacting Section 52 of the income tax statute was to extend the general income tax imposed on corporations to income received by receivers, trustees in bankruptcy, or assignees as a result of the operation of the business or property of which they have custody or control. (See *Reinecke v. Gardner*, 277 U. S. 239; *United States v. Chicago & E. I. Ry. Co.*, 298 Fed. 779 (N. D. Ill.).)[1] The facts of the instant case show clearly that the trustee was "operating the property or business of the corporation" within the meaning and purpose of the statute.

We may assume that the trustee's ultimate goal was the liquidation of the company and the termination of its business operations. But in the interim—while the trustee waited for favorable opportunities to dispose of the properties—he entered into business transactions involving the assets of the enterprise to realize income from them. Other than purchasing new properties, the trustee engaged in precisely the same kind of activities as were previously carried on by the bankrupt.

Broadly speaking, the trustee engaged in selling, leasing, renting and managing the real property. It has been long recognized that such activities amount to the operation or

---

[1]The Government's claims for taxes accruing during administration in bankruptcy is entitled to priority as an administrative expense. *In re Lambertville Rubber Co.*, 111 F. (2d) 45 (C. C. A. 3d); *Florida Nat. Bank of Jacksonville v. United States*, 87 F. (2d) 896 (C. C. A. 5th).

carrying on of business. (See *Flint v. Stone Tracy Co.*, 220 U. S. 107, 169-171; *Von Baumbach v. Sargent Land Co.*, 242 U. S. 503; *United States v. Peabody Co.*, 104 Fed. (2d) 267 (C. C. A. 6th); *Page v. M. Rich & Bros. Co.*, 99 Fed. (2d) 607 (C. C. A. 5th); certiorari denied, 306 U. S. 662; *Harmar Coal Co. v. Heiner*, 34 Fed. (2d) 725, 727 (C. C. A. 3d), certiorari denied, 280 U. S. 610.)

The trustee embarked upon a "selling program which would enable him to spread his sales over a period of time and take advantage of favorable market conditions". [R. 56.] While this was being done, the trustee rented certain of the properties for agricultural purposes and collected rents. The amounts received were applied to pay taxes, upkeep, and expenses, the balance being used to repay the bank loan. Moreover, the trustee executed oil and gas leases upon certain of the properties, from which he received bonuses and royalties aggregating $245,517.65 in 1938 and $206.333.36 in 1939. The moneys were paid to the bank by the trustee, upon orders of the court, to cover taxes assessed against the properties, costs of engineering services and checking oil and gas production, and to apply on the bankrupt's obligation to the bank. [R. 55.]

During these years, only a minor part of the trustee's operations involved the liquidation of assets. Clearly a comparison of the total receipts from properties sold—some $25,000—and the estimated value of the total property held by the trustee—some $880,000[2]—would indicate that any liquidation of the properties held was negligible

---

[2]The Security-First National Bank of Los Angeles, which had record title to approximately 90% of the real properties received by the trustee as security for a $1,500,000 indebtedness owed it, valued such security at $800,000 and credited it upon the indebtedness, filing an unsecured claim for $500,000. [R. 53.]

in extent. Moreover, the trustee's books for 1938 show receipts from sales of only $5,500, whereas rents, royalties, and bonuses of over $250,000 were collected. The 1939 records reveal that there were sales of $19,450, whereas rents and royalties amounted to in excess of $210,000. Although the trustee may have planned eventually to liquidate the property, it is plain that during the taxable years 1938 and 1939, he was in fact primarily engaged in operating the property or business to produce earnings and profits.

Certainly where a trustee in bankruptcy deals with the assets of a bankrupt in this manner he is operating the property or business within the meaning of the statute. In this connection it is important to emphasize that even if income is produced from a process of liquidation, there is no reason why it should be exempt from tax. As the Supreme Court stated in *Heiner v. Mellon,* 304 U. S. 271, 275, "Profits made in the business of liquidation are taxable in the same way and to the same extent as if made in an expanding business." *A fortiori,* there is no reason to exempt income earned from business operations, which were not themselves a liquidation, although conducted while awaiting favorable opportunity to liquidate. By the same token, there is no reason to exempt property from taxes merely because it is held by a trustee in bankruptcy or a receiver. (*Swarts v. Hammer,* 194 U. S. 441; *In re Tyler,* 149 U. S. 164, 182; *Buckley v. Commissioner,* 66 Fed. (2d) 394 (C. C. A. 2d), certiorari denied, 290 U. S. 698.)

Section 52 of the Revenue Act of 1938 should be construed in the light of its plain purpose to subject corporate enterprises, which are in the hands of receivers or

trustees, to income tax in the same manner as if they were still being operated by the officers and directors. This broad purpose should not be defeated by a restrictive construction of the phrase "operating the property or business".

It should also be noted that the statute does not require that *both* the property and business of the corporation be operated, but uses the disjunctive "or" between the words "property" and "business". Consequently, as a matter of technical construction, if either the property or business of a corporation is being operated by the trustee, the requirements of the statute are met. It is difficult to conclude that the trustee was not at least operating the *property* of the bankrupt. Certainly the trustee did virtually everything with the property that the corporation itself could have done, *i. e.,* sold some of the property, leased and rented other parcels, made repairs and improvements, and attempted to dispose of the remaining properties at favorable prices. That the corporation itself could have done more with such property is hard to conceive. (See G. C. M. 3876, VII-1 Cum. Bull. 127 (1928); I. T. 2626, XI-1 Cum. Bull. 55 (1932).)

It is obviously immaterial that there was no *general* order of the court authorizing or forbidding the trustee to operate the bankrupt's business. It appears that every transaction which the trustee entered into and executed was authorized and approved by the court, and it has not been suggested that he was acting outside the proper scope of his authority in conducting the operations. Even if he had, however, the point would be irrelevant in determining the application of the income tax law. *Cf United States v. Sullivan,* 274 U. S. 259, holding that

income from an illegal business is taxable. The statute clearly is concerned with what *in fact* the trustee did and not with what he was authorized to do. The determining consideration here is that the trustee did manage the bankrupt's assets to realize net income.

2. The Board of Tax Appeals has recently sustained the tax liability of an assignee under Section 52 in a similar situation where, in fact, there appears to have been far greater emphasis placed upon the liquidation of the business. (*Louisville Property Co. v. Commissioner,* 47 B. T. A. No. 6.) In this case, a receiver had been appointed for the purpose of paying the debts and winding up the affairs of the Louisville Property Company, a corporation which, by its charter, was authorized to deal in all kinds of property. H. C. Williams was appointed assignee and was assigned all of the assets of the company for the payment of the debts of the assignor and the expenses of administration, and the distribution of the remainder, if any, to the stockholders. Afterwards the corporation was to be dissolved. Williams proceeded to liquidate and dispose of the assets received as fast as he could advantageously without sacrificing their value. Some of the lands transferred to Williams contained minable coal, the rights to which had been leased to coal operators who paid Williams royalties on the coal mined. Williams at no time carried on any mining operations on the lands. The Board held that Williams was "operating the property or business" of the Louisville Property Company under Section 52 of the Revenue Acts of 1934 and 1936. The following quotation from the Board's opinion is squarely in point here:

> In the instant proceedings we think the evidence clearly shows that Williams was "operating the prop-

> erty or business" of the Louisville Property Company within the meaning of the applicable statute and regulations * * *. He was deriving income from sales of coal and timber, collecting rents, and entering into royalty contracts, and he disposed of approximately 12,000 acres of land * * *.

An excellent state court case construing the phrase "operating the property or business" within the meaning of Section 52 is *State v. American Bonding & Cas. Co.*, 225 Iowa 638, 281 N. W. 172. There a company which conducted a casualty insurance business was declared insolvent and dissolution directed. The receiver who was appointed took over the company's assets, but because of the magnitude and complexity of the claims did not reduce the assets to cash, but rather collected the interest on securities and rents from the real estate which he held and invested the money thus received in additional securities and collected income therefrom. A claim was filed by the United States under Section 52 for income taxes on income from the property in the hands of the receiver. The Supreme Court of Iowa held that the receiver was "operating the property or business". The following quotation from the court's opinion is particularly pertinent and equally applicable to the facts of the instant case (pp. 643-644):

> We think the question here discussed was very clearly and convincingly considered in the written opinion of the trial judge in the instant case wherein, after considering the meaning of the words "operating", "property", and "business", and sustaining his conclusion as to the meaning and implication of these words by abundant authority, he proceeded to say:

"The receiver says he is a liquidating receiver. To liquidate in its general and usual sense means to assemble and mobilize the assets, settle with the creditors and debtors, and apportion the remaining assets, if any, among the stockholders or owners. *Ex parte Amos,* 94 Fla. 1023, 114 So. 760, 765, *Lafayette Tr. Co. v. Beggs,* 213 N. Y. 280, 107 N. E. 644, 645, *Gilna v. Barker,* 78 Mont. 357, 254 Pac. 174, *Rohr v. Stanton Tr. & Sav. Bank,* 76 Mont. 248, 245 Pac. 947, 948.

* * * * * * * *

"In one sense this receivership is a liquidating receivership as the ultimate object is the liquidating of the company and it is true that the receiver was not operating the business as it was conducted by the corporation. On the other hand can it be said that he was not operating a part of the business, *that of investing the assets for the purpose of deriving revenue therefrom under the specific orders of this court. A fortiori* he was operating the property, within the meaning of the word as above defined, in taking possession of the assets, notes, bonds, and mortgages, collecting them, selling certain bonds and mortgages and reinvesting the proceeds in other bonds, mortgages, and securities, in managing such real estate as the corporation owned or the receivership acquired, in leasing, repairing, and collecting the rents and revenues therefrom. It seems to me that this receivership comes fairly within the phrase 'receiver operating the property or business', *especially in connection with the words occurring later in the statute, 'of whose business or property they have custody and control'.*" (Italics supplied.)

Moreover, a persuasive analogy in support of our position is to be found in the decisions of this court consid-

ering the question whether a trust is "doing business" so as to be taxable as an association. Thus in *United States v. Trust No. B I. 35, Etc.,* 107 Fed. (2d) 22, where the trustee collected proceeds from oil leases, renewed certain marketing agreements, and arranged for and executed an oil lease, this court held that the taxpayer was engaging in a productive business for profit and was thereby taxable as an association.

Again in *Kettleman Hills R. S. No. 1 v. Commissioner,* 116 Fed. (2d) 382, certiorari denied, 313 U. S. 582, this court held that a trust in corporate form, which administered royalty rights contracts with an oil company, and which had an option to receive interest in oil and gas or money, and a right to store and process and dispose of the oil and gas received, was (p. 383) "making a succession of business judgments" in determining whether it would "require the delivery of the royalty product in kind or in cash", and was thereby "doing business" so as to be subject to tax as an association, "though through the tax years in question it thought it better business to accept cash rather than the oil products". Likewise in the instant case the lease made by the trustee provided for a bonus of $25,000 and a royalty of 35% of the oil produced, such royalty being payable either in cash or in kind at the option of the trustee. [R. 158-159.]

Similarly in *United States v. Rayburn,* 91 Fed. (2d) 162, the Circuit Court of Appeals for the Eighth Circuit reached the same conclusion where the only business car-

ried on by the trustees was the execution of certain oil leases, the collection of bonuses and rentals and the distribution of the net proceeds to the beneficiaries. The court rejected the claim that the purpose of the trust was to liquidate the land and upheld the contention of the Government that one of the purposes of the trust was to hold the land (p. 165) "to await future opportunities", and while so doing, business was carried on.[3]

3. The conclusion that the trustee is liable for the tax upon the income in the circumstances of this case follows *a fortiori* from the interpretation of the statute contained in the applicable regulations. Treasury Regulations 101, Article 52-2; Treasury Regulations 103, Section 19.52-2. The regulations provide that:

> If a receiver has full custody of and control over the business or property of a corporation, he shall be deemed to be operating such business or property within the meaning of section 52, whether he is engaged in carrying on the business for which the corporation was organized or only in marshaling, selling, and disposing of its assets for purposes of liquidation.

---

[3]Of course, the fact that a wasting asset is being depleted does not mean that a property is merely being liquidated and no business carried on. *Von Baumbach v. Sargent Land Co., supra; Louisville Property Co. v. Commissioner, supra; Harmar Coal Co. v. Heiner, supra; Lyon Lumber Co. v. Harrison,* 113 F. (2d) 443 (C. C. A. 7th); *United States v. Hercules Mining Co.,* 119 F. (2d) 288 (C. C. A. 9th), certiorari denied 314 U. S. 658. See also, Treasury Regulations 64 (1936 ed.), Art. 43(a) (3). As this Court said in *United States v. Trust No. B. 1.* 35, *Etc., supra* (p. 26):

> A further false premise is that the owner of oil land, some leased and some free to lease, with oil sands developed at a certain depth and * * * the contemplated possibility of still deeper deposits, is not engaging in a productive business for profit when its lessee extracts the oil, but is merely liquidating its capital investment. To state the proposition is to refute it. * * *

This interpretation, of course, is equally apt in the case of a trustee as well as a receiver.[4] Thus, on the basis of the administrative construction which has been given the statute, the fact that the trustee was engaged in a program for the liquidation of the properties is alone sufficient to make him liable for the tax upon any income earned in the process. Even if the trustee had not engaged in leasing, managing and renting the properties but had merely realized income from the sale of the assets, he would be subject to the tax.

The validity of this interpretation—at least in its application to a situation where, as here, the trustee has embarked upon a program for the liquidation of the assets over a period of time—can hardly be questioned in view of the Supreme Court's recent decision in *Magruder v. Washington, Baltimore & Annapolis Realty Corp.*, decided April 13, 1942, not yet officially reported but found in 1942 C. C. H., Vol. 4, Par. 9416. In that case, the question was whether a liquidating corporation was "carrying on or doing business" within the meaning of Section 105(a) of the Revenue Act of 1935, and subsequent acts, and was therefore liable for capital stock tax. The taxpayer, since its incorporation, had been carrying on negotiations for the sale of its properties, selling them as satis-

---

[4]While the provision of the applicable regulation uses only the term "receiver", it can hardly be maintained that a trustee in bankruptcy or an assignee who marshals, sells and disposes of a corporation's assets for purposes of liquidation, should be treated differently for income tax purposes from a receiver who performs those identical functions. No sound reason would appear for drawing any such distinction. (See *Louisville Property Co. v. Commissioner, supra.*) Indeed the fact that a trustee in bankruptcy or assignee acquires title to the assets of the corporation while a receiver does not, would, if anything, be even more reason for imposing the tax upon the trustee. Both in Section 52(a) and in other provisions of the Revenue Acts, Congress has clearly evidenced an intent to treat trustees in bankruptcy and receivers of corporations in the same manner. See, *e. g.*, Sections 13(e), 52(a), and 274 of the Revenue Act of 1938.

factory offers were received, and renting unsold properties under short term leases in an attempt to earn the carrying charges pending ultimate sale. The regulations provided that (Treasury Regulations 64 (1936 ed.), Article 43(a) (5)—

> * * * "doing business" includes any activities of a corporation whether it engages in—
>
> * * * * * * * *
>
> (5) the orderly liquidation of property by negotiating sales from time to time as opportunity and judgment dictate and distributing the proceeds as liquidation is effected * * *.

The Supreme Court sustained the validity and application of the regulation. (See also, *Edgar Estates Corp. v. United States,* 65 C. Cls. 415; *Conhaim Holding Co. v. Willcuts,* 21 Fed. (2d) 91 (Minn.). See also G. C. M. 3876, VII-1 Cum. Bull. 127 (1938); I. T. 2626, XI-1 Cum. Bull. 55 (1932).)

If a corporation engaged in the type of activities performed by the trustee in the instant case is properly held to be "doing business" for purposes of the capital stock tax, it certainly must follow that the trustee in bankruptcy is "operating the business or property" within the meaning of Section 52(a).

The statutory phrase "operating the property or business," like the phrase "doing business" is patently of sufficient ambiguity to render an administrative interpretation appropriate. It is true that in many factual situations the meaning of the phrase "operating the property or business" will be perfectly obvious. But, on the other hand, here, as in the statutes using such expressions as

"net income * * * from the property"[5] or "ordinary and necessary,"[6] "the Congress has not prescribed a precise formula free from all ambiguity" (*Helvering v. Wilshire Oil Co.,* 308 U. S. 90, 102), or used terms "so clear and unambiguous in their meaning as to leave no room for an interpretative regulation" (*Textile Mills Corp. v. Commissioner,* 314 U. S. 326).

We can perceive no basis for questioning the reasonableness of the administrative interpretation in its application to the facts of the instant case. Moreover, the regulation has been in effect since 1934, and the successive reenactments of the statute since that date lend even greater support to its validity. (*Brewster v. Gage,* 280 U. S. 327; *Textile Mills Corp. v. Commissioner, supra. Cf. Morgan v. Commissioner,* 309 U. S. 78, 81; *Helvering v. Winmill,* 305 U. S. 79, 83.)

4. Cases which have held that a trustee was not operating a business or property under Section 52 are readily distinguishable on their facts. In *In re Heller, Hirsh & Co.,* 248 Fed. 208 (C. C. A. 2d), for example, the trustee in bankruptcy had done nothing more than collect the proceeds from a claim which he compromised arising under a contract entered into and completely executed by the corporation *prior to the bankruptcy.*

Other decisions have been handed down by the lower courts. In *In re Owl Drug,* 21 Fed. Supp. 907 (Nev.), the trustee in bankruptcy took over the drug stores which the bankrupt had formerly operated. The trustee, after

---

[5]Revenue Act of 1928, c. 852, 45 Stat. 791, 821, Sec. 114(b) (3); *Helvering v. Wilshire Oil Co.,* 308 U. S. 90, 102.

[6]Revenue Act of 1928, *supra,* Sec. 23(a); *Textile Mills Corp. v. Commissioner,* 314 U. S. 326.

selling the business and all of its assets as a going concern, deposited the proceeds thus received in various banks. The District Court held that the interest earned on such deposits was not gain derived from the operation of the bankrupt's property or business. It is obvious that in this case, unlike the present case, the income in question was earned after the actual business of the bankrupt had been liquidated. As the court itself declared (p. 911):

> After the bankruptcy, the trustee continued to operate the stores for a while. Then he sold them. When he did, *the business of the bankrupt was liquidated.*

The *Owl Drug* case is further distinguishable in that the trustee there was nothing more than a passive recipient of the income earned.[7] No activity was engaged in by him for the purpose of earning a profit, but rather the cash received from the liquidation was deposited merely to await the determination of the validity of certain claims.

Doehler Die Casting Co. v. Meadows Mfg. Co. (S. D. Ill.), decided September 20, 1938, not reported but found in 1938 C. C. H., Vol. 4, Par. 9498, is also distinguishable on the ground that the receiver had disposed of practically all the assets and become inactive except with respect to collecting certain accounts and royalties from contracts which the *corporation* had entered into.

---

[7]See *Foss v. Commissioner*, 75 F. (2d) 326 (C. C. A. 1st), distinguishing the passive receipt of income from the "carrying on of business" within the meaning of Sec. 23(a) of the Internal Revenue Code, which permits the deduction of business expenses.

Conclusion.

The order of the court below approving and affirming the referee's disallowance of the claim of the United States should be reversed.

Respectfully submitted,

SAMUEL O. CLARK, JR.,
Assistant Attorney General.

SEWALL KEY,
SAMUEL H. LEVY,
ARTHUR MANELLA,
Special Assistants to the Attorney General.

WM. FLEET PALMER,
United States Attorney.

E. H. MITCHELL,
Assistant United States Attorney.

EUGENE HARPOLE,
Special Attorney,
Bureau of Internal Revenue.

July, 1942.